BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

The question involved in this case has been set forth in the foregoing petition for certiorari. It is believed that this question, which is wholly one of law, has been definitely answered by repeated decisions in the Circuit Courts of Appeal in a majority of the Circuits, and that these decisions have, inevitably, followed from controlling decisions of this Court.

However, since none of these cases deal with "switching" transactions in commodity future contracts the decision of the Circuit Court of Appeals in the instant case will establish a precedent in an important field of business transactions, inconsistent with the recognized law governing similar transactions in securities.

Conflicting Decisions of the Circuit Courts of Appeal.

It is submitted that there are a large number of conflicting decisions of the Circuit Courts of Appeal. These decisions follow and accept the principle enumerated in a case arising in the Circuit Court of Appeals, Fifth Circuit, the same Circuit deciding the case at bar. The case referred to is *Esperson* v. *Commissioner,* 49 F. (2d) 259. In this case the taxpayer sold certain securities and at the same time repurchased an equal number of shares of the same stock through another person. The taxpayer claimed that the sale constituted a closed transaction resulting in a deductible loss. The court denied the deductibility of the loss in the following language at page 260:

> "The evidence is set out at length in the above-cited opinions of the Board, and abundantly sustains its conclusion that throughout it was Esperson's intention to keep the same number of shares of stock after the sales were completed that he had before any sales were made. Each share of the stock was of equal value; one

was as good as another. It may be assumed that an owner of stock would sustain a deductible loss by selling it and later buying back an equal amount, but no real sale is made whereby one and the same transaction the same number of shares are both bought and sold at the same price and at the same time."

In the case of *Commissioner of Internal Revenue* v. *Dyer*, 74 F. (2d) 685 (C. C. A. 2nd), the taxpayer sold certain securities and after slightly over thirty days repurchased similar securities. The Court, in denying the deductibility of the loss states, at page 686:

"In the case at bar the inference is inescapable that 'repurchase' of the stock by return of the notes was part of the original plan, and that from the beginning the transferors intended to reacquire their shares in this manner * * * Under these circumstances it is as though there had been an agreement between all the transferors and Elanco that the sale should be coupled with a contract, or, at least an option, to repurchase. The transferors' ownership of their stock was not so completely terminated as to constitute the realization of losses by reason of sales. Compare Esperson *v.* Commissioner, 49 F. (2d) 259 C. C. A. 5). In this aspect, the fact that with respect to the 1927 transaction a profit was reported by Elanco is immaterial."

In the case of *Shoenberg* v. *Commissioner*, 77 F. (2d) 446 (C. C. A. 8th), the taxpayer sold certain shares of stock and at the same time caused a corporation controlled by him to buy an equal number of the same shares of stock. After a period of thirty days the taxpayer repurchased these securities from the controlled corporation. In refusing to permit a deduction of a loss on the sale, the Court stated, at page 449:

"However, where such sale is made as part of a plan whereby substantially identical property is to be reac-

quired and that plan is carried out, the realization of loss is not genuine and substantial; it is not real. This is true because the taxpayer has not actually changed his position and is no poorer than before the sale. The particular sale may be real, but the entire transaction prevents the loss from being actually suffered. Taxation is concerned with realities, and no loss is deductible which is not real."

Other cases accepting and applying the same principle of law are:

Foster v. *Commissioner*, 96 F. (2d) 130 (C. C. A. 2nd);
Commissioner v. *Riggs*, 78 F. (2d) 1004 (C. C. A. 3rd);
Commissioner v. *Troup*, 75 F. (2d) 1010 (C. C. A. 7th);

and see

Helvering v. *Johnson*, 104 F. (2d) 140, at page 143 (C. C. A. 8th);
Commissioner v. *Neaves*, 81 F. (2d) 947, at page 949 (C. C. A. 9th).

There should be noted in connection with these cases the following significant facts:

(1) These cases clearly state that a motive of the taxpayer to reduce his tax liability is not the basis of the decision.

(2) None of the cases come within the provisions of the so-called wash sales section of the Revenue Acts, which Section is 118A of the Revenue Act of 1938, and appears in virtually the same language in every Revenue Act since the Revenue Act of 1921.

(3) The cases are not based on the proposition that no sale took place. They are, rather, based upon the theory that where property is sold with an intention to reacquire substantially the same property that there has been no loss, because, in substance, there has been no change in the eco-

nomic status of the taxpayer. It is submitted that this principle is applicable to the instant case. Here there was no intention to part with the ownership of the property, but, on the contrary, an affirmative intention to retain ownership of the property, and the sales and purchases were made for the purpose of maintaining the same economic status. It happened that because of the rules of the commodity exchanges involved, the only way that ownership could be maintained and the economic status maintained would be a sale with a simultaneous repurchase. Thus, the reacquisition of the substantial equivalent of the property sold was not only in contemplation at the time of the sale, it was of the essence of the sale.

This Principle Has Been Accepted by the Board of Tax Appeals.

The principle of the cases cited above has been accepted and articulated by the Board of Tax Appeals in the following cases:

H. Rodney Sharp, 38 B. T. A. 166, at page 174;
Jos. W. Powell, 34 B. T. A. 655, at page 661;
Pierre S. Dupont, 37 B. T. A. 1198, at page 1266;
Joseph Blumenthal, 30 B. T. A. 125, at page 131.

Conflicting Decisions of This Court.

The underlying rationale of the foregoing cases is the oft repeated judicial maxim that in matters of taxation substance shall prevail over form. That maxim has been often announced and applied by this Court. See, for example, *Griffith* v. *Helvering,* 308 U. S. 355; *Southern Pacific Company* v. *Lowe,* 247 U. S. 330; *United States* v. *Phellis,* 257 U. S. 156; *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, and *Eisner* v. *Macomber,* 252 U. S. 189.

And cf. *Bowers* v. *Kerbaugh Empire Co.,* 271 U. S. 170.

This maxim has been applied in disregard of apparent transfers where there was no real change in the economic status in the following recent decisions of this Court:

In *Helvering* v. *Clifford,* 309 U. S. 331, this Court held taxable to the grantor the income of an irrevocable term trust on the ground that although a separate trust had been established in form, in fact and reality there had been no real relinquishment of control and ownership.

In the case of *Higgins* v. *Smith,* 308 U. S. 473, this Court held that no deductible loss was incurred by the sale of the property to a controlled corporation on the ground that although a sale had been consummated in form, there was, in reality, no real relinquishment of ownership.

In the case of *Pearson* v. *McGraw,* 308 U. S. 313, there was involved the application of the Oregon Inheritance Tax to a transfer in contemplation of death made by a decedent, a resident of Oregon. Prior to his death decedent had certain bonds and other intangibles in the possession of an Illinois trust company, which was acting as fiscal agent and depository for him. He instructed the Illinois trust company to sell the bonds and purchase Federal Reserve notes. For the purpose of this case the court regarded the Federal Reserve notes purchased by the Illinois trust company as tangible personal property. The decedent thereupon had the Federal Reserve notes transferred to the Illinois trust company, as trustee, to be held in trust, irrevocably for certain members of the decedent's family. Shortly after the establishment of this trust the trustee invested the Federal Reserve notes in bonds and other type of intangible property. The Supreme Court of Oregon and the Supreme Court of the United States accepted as controlling legal principles in the case the proposition that intangible property has a tax situs in the State of residence of the owner, but that tangible property has a tax situs where the property itself was physically located. In accordance there-

with the Supreme Court of Oregon held that since the subject of the gift in trust was the tangible Federal Reserve note, the tax situs thereof was in Illinois and the Oregon Inheritance Tax was not applicable. This Court reversed the ruling holding that the sale of the bonds originally and the investment of the proceeds in Federal Reserve notes, and the later reinvestment of the Federal Reserve notes in intangible property were all steps in one preconceived plan, and the actual result intended and accomplished was the transfer in trust of the originally held intangible property, and, consequently, the tax situs was in Oregon, and the transfer was subject to the Oregon Inheritance Tax. In reaching this result this Court used language which we believe embodies and accepts the argument we have contended for and we quote this statement from pages 317 and 318 of the opinion:

> "On the facts of this case we believe that the various steps in the series must be considered as constituting but one integrated and indivisible transaction—a transfer by decedent of intangibles in contemplation of death. And we reach this result though each step in the series was real and though none was camouflaged or concealed. For basically the sale of intangibles, the acquisition of federal reserve notes, and their transfer under the agreement of August 15, 1935, were interdependent. Cf. Groman *v.* Commissioner of Internal Revenue, 302 U. S. 82; Helvering *v.* Bashford, 302 U. S. 454, 458. From decedent's point of view, completion of the series of steps was necessary for consummation of his program to utilize $450,000 of his estate to provide for certain designated members of his family. Any step short of the final transfer would not have done it. The mere sale of the intangibles and the acquisition of the federal reserve notes had no functional or business significance apart from the August 15, 1935 transfer. That is emphasized here because they created no legal relations and gave rise to no vested rights

interfering with decedent's continuing power of disposition. Taken as isolated transactions, they have meaning and significance only in relation to the third step, a conclusion made especially evident by the close sequence of events. Hence, it is no answer to say that because the first two steps were not irrevocable but could be recalled the third step was not a necessary one in the series. For that is as immaterial as is the revocability of any donor's plan to make a gift in contemplation of death at any moment prior to its consummation. Admittedly decedent had such a purpose on the transfer of the notes. To hold that such purpose was not present on the sale of the intangibles would be to isolate one part of the total transaction and to give it significance and meaning utterly inconsistent with the fact that the intangibles were sold for the purpose of acquiring the notes which, in turn, were to be placed under an irrevocable trust. Therefore we need not consider the nature of federal reserve notes, for in that posture of the case their taxability as such and in isolation from the whole transaction is not in issue."

Substance Should Prevail Over Form.

It is fully realized that the maxim "substance should prevail over form" is a statement of a judicial attitude rather than a rule of law, and as such it can not be automatically and indiscriminately applied to all the various circumstances which can arise in the administration of the Revenue Laws. Nevertheless, it is believed that this maxim through constant application by the Circuit Courts of Appeal to similar situations, has crystalized in to the rule of law here contended for. The decision in the instant case represents a retreat from the constantly extending application of this judicial attitude, and this is unfortunate. Whichever way this case may be decided should not affect the revenue of the Treasury Department. Rather since the wash sales provisions of the Revenue Act do not apply to

commodity transactions, the instant decision would permit the creation of artificial losses by switching transactions undertaken for that very purpose, and, hence, tend to deplete the revenues of the Treasury. But, irrespective of this consideration it can be in the interest of no one to permit the National Tax Laws to be governed by the fortuitous circumstances present in this case, or the artificial technicalities of legal form. Wherever economic substance conflicts with legal formality it should be the inclination of all concerned to follow the path of reality.

Because the present decision conflicts with this rule; and because it presents a conflict in principle with other circuits; and because there should be as little confusion as possible in our tax laws, the writ should be granted in this case.

Respectfully submitted,

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